February 28, 2006

John Hester
Director, Telecommunications Division
Illinois Commerce Commission
Suite C-800
160 N. LaSalle St.
Chicago, IL 60601
JHester@icc.state.il.us

Re: Request for Comments on a Just and Reasonable Standard
For Competitive Telecommunications Services

Dear Mr. Hester:

In response to the Staff request for informal comments on when and how the Commission should undertake an investigation into whether rates charged for telecommunications services that are classified as competitive are just and reasonable, the People of the State of Illinois, by Attorney General Lisa Madigan, submit the following:

In order to respond, the history and purpose of the just and reasonable rate doctrine must be established and agreed upon. Under regulation, just and reasonable rates were determined to be rates that covered the cost of service[1] and provided the Company's investors a reasonable return on investment. In Citizens Utility Board v. ICC, 276 Ill. App.3d 730, 736-737, 658 N.E.2d 1194, 1200 (1st Dist. 1995), the Court referred to extensive precedent for the proposition that fixing just and reasonable rates Ainvolves a balancing of the investor and the consumer interests.@ The Court continued: "The Commission has the responsibility of balancing the right of the utility=s investors to a fair rate of return against the right of the public that it pay no more than the reasonable value of the utility=s services."

Rates that are not set under rate of return regulation are subject to a broader evaluation that includes the public policy goals stated by the General Assembly in Article XIII. Illinois Bell Telephone Co. v. ICC, 283 Ill.App.3d 188, 202 (2d Dist. 1996). A rate increase that results in an unreasonable mark-up over cost and bears no relation to other public interest goals such as universal service, affordability and choice, should be subject to review under the just and reasonable standard so that the public interest as stated by the General Assembly and investors' interests remain fairly balanced.

[1] Cost of service includes expenses like employee levels, taxes and supplies; return on invested capital (profit) and return of invested capital (depreciation).

Historically, telecommunications services in Illinois were provided by a company given a state-sanctioned monopoly, and regulation imposed price discipline and encouraged certain social goals such as universal service and high service quality. With the introduction of competition into telecommunications services, it was assumed that at some time sufficient competitive price constraints and service quality pressure would arise to replace regulation. 220 ILCS 5/13-103(b). The key consideration in reviewing a rate change to a service classified as competitive is: is the rate change consistent with the goals of the General Assembly, and does it reflect the constraints on prices and profits expected in a competitive market, or are consumers being asked to pay unfair and excessive prices due to a lack of sufficient competitive constraints?

It is crucial to recognize that the General Assembly retained the requirement that telecommunications rates be just and reasonable for services classified as competitive. This evinces the policy that telecommunications services continue to be viewed as essential public services. Although competition can be expected to provide the constraint on prices and profits that regulation had provided during the period of state-sanctioned monopoly, the retention of the "just and reasonable" pricing requirement even for "competitive" services confirms that prices are expected to be reasonable regardless of whether the price is set by regulation (e.g. by Commission investigation or section 9-250 complaint) or competition. The Commission has an ongoing responsibility to assure that this legislative expectation is fully and continuously realized.

The following comments are premised on this understanding of the role of competition and of the term "just and reasonable" rates.

Need for a rulemaking The People of the State of Illinois, while submitting informal comments in response to Staff's request, recommend that the Commission open a formal rulemaking to consider the question of when a competitive telecommunications rate filing should be subject to a Commission investigation into whether it is "just and reasonable." The establishment of clear and known standards for investigation will have the dual effect of allowing the public to have confidence that certain types of rate changes will be considered by regulatory authorities, and of informing the carriers what factors will be considered in opening an investigation. Known standards provide guidance to consumers and providers alike.

Notwithstanding the need for a rulemaking, if the Commission believes that rates for particular services classified as competitive should be investigated, an alternative approach is to open an investigation and obtain information in the investigation along the lines discussed in these comments. A docketed investigation, in which specific facts and circumstances can be examined, is another avenue for exploring the factors that should be considered in determining whether a rate is just and reasonable or should be modified.

These comments will address the substance of the questions presented by the Staff and provide input into the key issues raised by rate changes for

telecommunications services that have been classified as competitive through legislation, Company filing or litigation.

Q Should the Commission's decision(s) concerning whether to investigate rates for competitive telecommunications services differ according to provider types and sizes, service or product types, market conditions, service areas, or other such factors? If so, please explain how the Commission's exercise of its authority should vary across such differing factors and why.

The People believe that the Commission should consider incumbency (provider type), size, services, and market conditions in determining whether to investigate whether a rate change is just and reasonable.

Provider type: The Commission should view ILEC rate changes differently from CLEC rate changes. The telecommunications market reflects its origin as a state-licensed monopoly service, where the regulatory system encouraged private investment in infrastructure to provide universal service to the public. Incumbent local exchange carriers ("ILEC") invested in infrastructure to provide universal service to a designated service area in return for a monopoly franchise and rates that reflected expenses, return on invested dollars, and return of invested dollars through depreciation. As a result, ILECs own existing, legacy telecommunications infrastructure, such as loops, central offices, switches, transport facilities and extensive networks of supporting structures – poles and conduits – that were constructed on public ways during their monopoly era. Through their ownership of these assets, ILECs are in a position to dictate the terms of their non-facilities (UNE-based) and facilities-based rivals' access to such infrastructure and facilities.

In opening the telecommunications industry to competition, the United States Congress required ILECs to provide competitive local exchange carriers access to "unbundled network elements" ("UNEs") so they could reach consumers without the need to reproduce the existing infrastructure. See Telecommunications Act of 1996, 47 U.S.C. 251-252. As demonstrated by the confidential data provided to the Commission under 83 Ill.Adm Code 790.350 as well as the 2004 Annual Report on Telecommunications Markets at page 14, many CLECs rely on facilities leased from the ILEC, i.e. unbundled network elements or UNEs, to provide service to mass market consumers.

The FCC's treatment of UNEs, including the UNE-P[2], has removed much of the federal protection and certainty from which CLECs had benefited in connection with the use of UNEs. Current litigation over section 13-801[3] of the Public Utilities Act and the state-based right to access UNEs has compounded this

[2] The UNE-P is a service that includes the switch, which routes calls and provides various services like Caller-ID, and the loop, which is the line running from the switch to the customer's premises. It enables CLECs with no infrastructure of their own to provide telecommunications services to the public.
[3] 220 ILCS 5/13-601.

uncertainty among the substantial number of CLECs that rely on legacy ILEC infrastructure to offer service. The alternative to UNE-based service requires CLECs and the ILEC to agree on rates in a commercial agreement that is not subject to regulatory review. Given the extreme disparity in market power between the ILEC and any individual CLEC, these "commercial agreements" can more accurately be described as "contracts of adhesion" and are not alone sufficient to guarantee that rates classified as competitive remain just and reasonable.

According to the Commission's 2005 Annual report, as of December 31, 2004, 61% of CLEC lines relied on UNEs (i.e., ILEC facilities) in MSA 1, while in other MSAs the percentage was 97-98%. When one company owns the infrastructure needed by other companies to offer service, it is appropriate to view that company differently than other companies which are dependent upon it both because of its size (see below) and because of its ability to control access to infrastructure needed by competitors. For example, if the ILEC raises wholesale prices, it can drive retail prices up notwithstanding that its costs have not increased. Accordingly, the rate increases proposed by ILECs should be subject to closer scrutiny than the increases of those companies that rely on ILEC facilities to offer retail service.

Size. The Commission should give more attention to companies with large numbers of customers in assessing rate changes. Notwithstanding the introduction of competition into the telecommunications industry, there are some companies with significant market share. The Commission's last "Annual Report on Telecommunications Markets in Illinois", dated May 24, 2005 and reflecting December, 2004 data, demonstrates the difference in the market shares of ILECs and *the sum* of the various competitive local exchange companies' ("CLEC"). Even in areas with the highest percentage of reported CLEC lines (MSA 1, 9 (Springfield)), the ILEC lines outnumber the total CLEC lines by at least two-to-one. In many other areas, the ILEC reportedly continues to provide service to more than 90% of the lines. See id. at Table C 1.

The 2004 Report may overstate the number of competitive lines today. It was based on data that treated pre-merger AT&T Illinois lines as "CLEC lines" rather than "ILEC lines." Now that AT&T and SBC have completed their merger and the substantial number of lines provided AT&T have been absorbed by SBC (now AT&T), the size disparity has become even greater.

When one company has a large portion of the market, it has substantial influence on other suppliers' prices. CLECs and consumers can be expected to know the prices of the largest supplier (particularly when that supplier is also the incumbent), and those prices can set the standard for new entrants' prices. Further, a significantly smaller company may lack the capacity to compete for more than a relatively tiny portion of the ILEC or larger company's market,

making its ability to constrain prices illusory.[4] Accordingly, the Commission should expressly consider the size of a company requesting a rate change in determining whether to investigate a particular rate change due to a large company's disproportionate effect on the market.

Services. **The Commission should scrutinize rate changes for unbundled services and ancillary services more closely than other service changes.** The General Assembly has declared that telecommunications services "should be available to all Illinois citizens at just, reasonable and affordable rates and that such services should be provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest." 220 ILCS 5/13-103(a). The Commission should consider the type of service subject to a rate change when assessing whether to investigate it further. For example, basic telephone service such as unbundled access, measured usage, and unbundled vertical services should be scrutinized more closely than packages because the unbundled prices available to consumers inform their view of whether a packaged or bundled service is economic or beneficial to them.

Charges or services that are related solely to the carrier selected, such as the price for directory listings, operator services, and late payment charges, should also be reviewed to ensure that consumers are not charged an excessive amount for services that are ancillary to the primary service being purchased. Consumers cannot choose to purchase these services from a company other than their provider of telephone service, and the Commission should consider whether consumers would be subject to unreasonable and excessive charges if changes in the rates for these types of services are requested.

Market conditions. **The market conditions existing in various parts of the State and for various products should be considered.** If a service is declared competitive, presumably consumers can obtain the service from more than one provider. However, demographic and economic differences in service areas exist and the extent of competition varies over time.[5] Business services in Illinois Bell Telephone Company's service area, which includes parts of nine MSAs,[6] covering diverse types of markets, were declared competitive by statute, irrespective of the level of competition in those areas. 220 ILCS 5/13-502.5(b). Vertical services, which can only be purchased from the company from whom the consumer buys his or her access line, were also declared competitive by legislation, irrespective of actual competition. 220 ILCS 5/13-505.2(c). The Commission should consider whether market conditions in a particular location

[4] As shown on documents filed in response to 83 Ill. Adm. Code Part 790.350(a), most CLECs provide service to fewer than 20,000 lines, while there are about 8.1 million lines in the state. 2004 Annual Report on Telecommunications Markets, Table C1.

[5] See the Commission's 2004 Report to the General Assembly on Telecommunications Markets in Illinois. See Table 8, pages 17-18.

[6] An MSA, or Market Service Area, is a geographic area designated by the United States District Court in the anti-trust action that broke up AT&T in 1983. The Illinois MSA map can be found in the 2004 Annual Report on Telecommunications Markets in Illinois at page 35.

(or statewide) indicate that rate changes for a particular service are fair and are being constrained by competition, or should be investigated.

Q Should the Commission require that carriers submit information (e.g., cost studies) to assist it in determining whether to open an investigation into the justness and reasonableness of rates for competitive telecommunications services? If not, please explain.

If yes, please address (at a minimum) the following in your answer:

- **a) The source of the Commission's authority to require such information.**
- **b) A list of such potential information, the purpose of each item, and the circumstances under which the item should be provided.**
- **c) An assessment of whether, and if so why, tariff filings that exceed certain thresholds require more detailed explanations and backup than tariff filings that do not exceed these thresholds? If yes, please provide examples of appropriate thresholds and the additional information that should be required with such a filing.**
- **d) An assessment of whether the Commission should specifically impose on carriers proposing rate changes a requirement that the carrier provide *prima facie* evidence that the proposed changes yield just and reasonable rates?**
- **e) An assessment of whether the Commission should require carriers to file annual demand, rate and/or other data related to their provision of competitive services including an explanation of what should be filed and under what circumstances.**

Yes, the Commission should require certain minimum information in order to determine whether it should open an investigation into whether a rate is just and reasonable. This information should be available to government and consumer representatives, subject to appropriate protective orders, and available for use in the event that they file a complaint about a rate change.

(a) <u>Authority to require information filing</u>. Article XIII of the Public Utilities Act covers telecommunications. It provides that the rates and services as well as the rules and regulations for services that are classified as competitive "shall be just and reasonable." 220 ILCS 5/13-101; <u>Id.</u> at 13-503, incorporating section 9-101("All rates and other charges …shall be just and reasonable."). Section 13-505 provides that: "If a hearing is held pursuant to Section 9-250 regarding the reasonableness of an increase in the rates or charges of a competitive local exchange service, then the telecommunications carrier providing the service shall have the burden of proof to establish the justness and reasonableness of the proposed rate or charge." 220 ILCS 5/13-505(b).

Telecommunications services can only be offered if "a tariff is filed with the Commission which describes the nature of the service, applicable rates and other charges, terms and conditions of service, and the exchange, exchanges or other geographical area or areas in which the service shall be offered or provided." 220 ILCS 5/13-501(a). The Commission has adopted rules that govern the filing of tariffs for both competitive and non-competitive services. See 83 Ill.Adm.Code Part 745 and Part 255. Amendments to these rules, consistent with these comments, may be necessary for the Commission to adequately review competitive filings to determine whether to investigate whether they are just and reasonable.

The law makes both competitive and non-competitive telecommunications services subject to certain provisions of the PUA, including sections 4-101 and 9-250 and Article X. 220 ILCS 5/13-101. These sections plainly give the Commission authority to require local telephone companies to provide information to the Commission so that the Commission can be assured that their rates and practices are just and reasonable.

Section 4-101 is a broad grant of authority. It provides:

> The Commerce Commission shall have general supervision of all public utilities, except as otherwise provided in this Act, shall inquire into the management of the business thereof and **shall keep itself informed as to the manner and method in which the business is conducted. It shall examine those public utilities and keep informed as to their general condition, their franchises, capitalization, rates and other charges,** and the manner in which their plants, equipment and other property owned, leased, controlled or operated are managed, conducted and operated, not only with respect to the adequacy, security and accommodation afforded by their service but also with respect to their compliance with this Act and any other law, with the orders of the Commission and with the charter and franchise requirements.

220 ILCS 5/4-101 (bold added).

Article X, which is applicable to competitive services pursuant to Section 13-101, provides the rules governing Commission hearings and investigations. Specifically, it empowers the Commission to "hold investigations, inquiries and hearings concerning any matter covered by the provisions of [the PUA]" and "to compel the attendance and testimony of witnesses, and the production of papers, books, accounts and documents." 220 ILSC 5/10-101. The Commission can require the filing of certain information to enable it to both supervise competitive telecommunications companies and to investigate whether competitive rates are just and reasonable.

(b) and (c) Information to be provided. There is threshold information that the Commission should review in deciding whether to investigate a rate change for a service classified as competitive. That information should include, at a minimum and without prejudice to other recommendations by other parties:

1. Whether the company is an ILEC as defined at 47 U.S.C. §251(h) or offers both competitive and non-competitive services as defined by 220 ILCS 5/13-210.

2. How many customers the company has. In light of the potential confidential nature of this information, the companies can be asked to indicate whether they have <25,000 lines, <200,000 lines or <1 million lines or >1 million lines. The appropriate cut-off points should relate to the number of customers served by the company or in the service area or market.

3. A description of the service as required by 83 Ill. Adm. Code 745.200 and 83 Ill. Adm. Code 255.30.

4. A description of the new rate and the prior rate, and the percentage change (increase or decrease) resulting from the tariff change. If the percentage change is greater than inflation, the increase should be explained.

5. The intra-state and total company return on equity for the Company as a whole.

6. The intrastate and total company return on equity for services reclassified as "competitive."

7. Incremental and fully allocated costs for the service, with more detail required if the return on equity for services classified as "competitive" is unreasonable.

8. The market conditions where the new tariff will become effective, in conformity with 83 Ill.Adm.Code 745.200(c).

9. Consumer complaints concerning the Company requesting the rate change received by the Company and by the Commission's consumer services division, including informal complaints, formal complaints, and "protests."

10. Whether the proposed rate change will affect the rates of existing customers or whether the rates of existing customers will be "grandfathered." Rates for equivalent services offered by the Company may also be considered.

11. How are consumers being notified of the change.

(d) No prima facie finding. The question before the Commission when a competitive tariff is changed is whether the Commission will investigate the tariff. There

are many considerations that go into that decision, including available resources. A competitive tariff, like any other tariff, is always subject to complaint under Section 9-250, and not investigating a competitive tariff is not a finding, implicit or otherwise, that the tariff is "just and reasonable." Further, the information to be filed with a competitive filing is not alone sufficient to constitute *prima facie* evidence that the tariff is "just and reasonable" and therefore not subject to further review.

Q. Are there any specific factors or circumstances that might automatically "trigger" a Commission Section 9-250 investigation into whether a rate change for a competitive telecommunications service is just and reasonable? If yes, please provide an explanation or justification for each proposed trigger, an analysis of the how such a trigger would be applied, and an explanation of what information would be necessary to apply such a trigger. Examples of factors that might be incorporated into such criteria are:

Yes, the Commission should consider the specific factors and circumstances identified in this question, as well as other factors, as more fully set out below in response to each listed factor.

a) **Markup over incremental cost** - Cost data should be provided in the original request for a rate change, with more detail required if the return on equity for services classified as "competitive" is unreasonable or other public interest concerns are implicated. For example, the Commission should insure that the rates and charges for non-competitive services do not include the costs attributable to competitive services.

b) **Number of competitors providing the service** – This information should be included in a description of the market where service is offered. The fewer competitors identified, the greater the risk that the price constraining effects of competition are not present.

c) **Comparison to rates charged by competitors for similar or identical services** - Although this information may be informative if the proposed rate is below competitors' rates for similar services, the key factors are the increase over existing rates, availability or ubiquity of other rates, affordability, choice and the company's profit level.

Comparisons to other rates alone may create the expectation that companies whose prices are lower than other companies can legitimately increase those rates without scrutiny notwithstanding their need for an increase. This would undo the consumer savings and benefit that competition was intended to produce by sanctioning rate increases if other companies have higher rates.

d) **Percentage increase over existing rate** – The percentage increase over the existing rate for equivalent services should be filed so that the Commission can assess the effect of the change on consumers. When a proposed increase exceeds the rate of inflation, the company should have to explain why the increase is appropriate.

e) **Complaints** – The Commission should be sure that it has not received substantive or relevant complaints from companies seeking to increase rates. The nature of the complaints should be examined to ensure that companies that fail to comply with consumer protection laws are not allowed to automatically increase charges to consumers. Carriers should inform the Commission of the complaints they have received and resolved and the Commission should consider complaints, protests and other correspondence it has received from consumers of the carrier.

f) **Discrimination** – If the new rate is discriminatory, it should not be considered just and reasonable.

g) **Reasonableness of profits** – Rate increases when the company is receiving unreasonable profits indicate that the competitive market is not providing price constraint, and that regulation is necessary to insure a fair balance between shareholders and the consuming public. Carriers should provide the intra-state and total company return on equity for the Company as a whole and the intrastate and total company return on equity for services reclassified as "competitive."

h) **Markup over fully allocated costs** – Mark-up over fully allocated costs for the service should be provided, with more detail required if the return on equity for services classified as "competitive" is unreasonable. The information submitted to the Commission should demonstrate that the rates and charges for non-competitive services do not include any costs attributable to competitive services, and cover an appropriate portion of fully allocated common costs.

i) **Consistency with other specified statutory and/or public policy goals** -- Rates that violate public policy goals such as universal service, affordability, non-discrimination, and consumer choice are not just and reasonable.

j) **The availability of substitute services** – If there are no substitute services available to consumers in any of the areas where the service is offered, the rate must be more closely scrutinized in connection with its relation to cost and the company's overall intra-state rate of return.

k) **Elasticity of demand** – Services with little elasticity of demand, or that are ancillary services (e.g., directory listings, operator services, returned check charge) should receive closer scrutiny because consumers must accept these terms if they subscribe to a particular carrier's telecommunications service.

l) **Industry studies relating to the services in question** – Industry studies are essentially hearsay documents, and are often prepared at the behest of interested parties. If industry studies are considered at all, they should be considered only as secondary evidence of the matters to which they relate with due regard for the interests of the studies' authors.

m) **Wholesale services** - Prices of wholesale services furnished by the ILEC to competitors for use in providing services that form the competitive alternatives to the ILEC service, whether the wholesale services are being provided by as a UNE or under a "commercial agreement," should be reported when the ILEC seeks a rate change.

n) **Unbundled rates** - Changes to rates that are components of bundles or packages, such as unbundled access, measured usage, unbundled vertical services, or other "a la carte" service rates should be more closely scrutinized because they are the inputs consumers consider in deciding whether package rates are economical.

Q. Should the Commission investigate (through a Section 9-250 hearing) whether a rate change for a competitive telecommunications service is just and reasonable without previously determining a "just and reasonable" standard appropriate for competitive telecommunications service rates? That is, should the Commission establish criteria in a rulemaking or other "global docket" to determine whether a rate for a competitive telecommunications service is just and reasonable or should the Commission review each tariff on a case by case basis? Please explain.

The standard for "just and reasonable" rates is well-developed in Illinois caselaw. Accordingly, the Commission could investigate a competitive rate even in the absence of a rule. It has the authority to seek the information that is relevant and probative and to determine whether a rate for a competitive service or services is just and reasonable.

Notwithstanding its authority to investigate whether a particular rate or rates are just and reasonable, the Commission should open a rulemaking to develop a working definition for "just and reasonable" rates for services classified as competitive, and a

set of filing requirements relevant to that standard. As discussed on pages 1-2 above, the Illinois courts have defined just and reasonable rates to be rates that result in a fair balance of consumer and shareholder interests. When competitive rates are reviewed, various factors such as those discussed above, need to be explicitly included in the assessment of whether the rate change is just and reasonable.

Among the factors that should be included in determining whether a rate is just and reasonable are:

(1) the balance of consumer and shareholder interests and whether competition is constraining prices and shareholder profits (including rates of return and mark-up over cost);

(2) whether the rate comports with public interest goals such as universal service, non-discrimination, affordability, choice and other goals established by the General Assembly;

(3) service quality;

(4) whether non-competitive services are subsidizing the rates of competitive services;

(5) complaints from consumers or public officials; and

(6) the availability and pricing of wholesale services by the ILEC for use by competitors in providing the putatively competitive service (e.g. are increases in wholesale rates driving up or otherwise affecting retail prices).

Q Please explain how the "just and reasonable" concept is most appropriately applied to competitive telecommunications services. Please include the following in your answer:

a) Any case law you believe to be directly pertinent or applicable.

b) A proposed "definition" of just and reasonable - as applied to rates for competitive telecommunications services.

c) A list of criteria that would allow the Commission to determine whether a rate for a competitive telecommunications service is just and reasonable. Please provide an explanation or justification for each proposed criterion, an analysis of the how such criteria would be applied, and an explanation of what information would be necessary to apply such criteria.

Examples of factors that might be incorporated into such criteria are:

- **i) markup over incremental cost;**
- **ii) number of competitors providing the service;**
- **iii) comparison to rates charged by competitors for similar or identical services;**
- **iv) percentage increase over existing rate;**
- **v) complaints;**
- **vi) discrimination;**
- **vii) reasonableness of profits;**
- **viii) markup over fully allocated costs;**
- **ix) consistency with other specified statutory and/or public policy goals;**
- **x) the availability of substitute services;**
- **xi) elasticity of demand; and**
- **xii) industry studies relating to the services in question.**

(a) and (b) The just and reasonable standard. The just and reasonable standard is well-established in Illinois law. In Citizens Utility Board v. ICC, 276 Ill.App.3d 730, 736-737 (1st Dist, 1995), the Court referred to extensive precedent for the proposition that fixing just and reasonable rates "involves a balancing of investor and consumer interests." Specifically, the Court said:

> The Commission has the responsibility of balancing the right of the utility's investors to a fair rate of return against the right of the public that it pay no more than the reasonable value of the utility's services. While the rates allowed can never be so low as to be confiscatory, within this outer boundary, if the rightful expectations of the investors are not compatible with those of the consuming public, it is the latter which must prevail."

276 Ill.App.3d at 737, *quoting* Camelot Utilities Inc. v. ICC, 51 Ill.App.3d 10 (1977); Illinois Bell Telephone Co. v. ICC, 414 Ill.275, 287 (1953); Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944). This balance remains a key element in assessing the fairness of rates, even for services classified as competitive.

In the context of alternative regulation, the Court expanded the considerations that go into the just and reasonable standard. In particular, the Court recognized that factors other than profit levels were relevant to whether a rate was just and reasonable, and specifically focused on the policy goals expressed by the General Assembly when it amended Article XIII. The Court said:

> "The legislature has expressly found that 'affordable telecommunications services are essential to the health, welfare and prosperity of all Illinois citizens' (220 ILCS 5/13--102(a) (West 1994)) and that competition should be used as a substitute for traditional regulation when consistent with protecting consumers (220 ILCS 5/13-- 103(b) (West 1994)). Implicit in the former finding is that the

absence of affordable telecommunications services would be detrimental to the public health, welfare, and prosperity. Having identified this problem and enacted section 13--506.1 as part of a comprehensive scheme to address the problem, the legislation is presumed to be a valid exercise of the police power."

Illinois Bell Telephone Co. v. ICC, 283 Ill.App.3d 188, 202 (2d Dist. 1996). Although profit level is still a consideration, the other public policy goals of Article XIII are also important factors in assessing whether a rate classified as competitive is just and reasonable and furthers the public interest. *See also* Illinois Bell Telephone Co. v. ICC, 327 Ill.App.3d 768 (2002)(Commission properly considered "best practices" and competition policy in apply just and reasonable standard).

The premise of competition is that various companies vie to provide service at rates and of such quality that consumers benefit by lower prices and increased variety. See 220 ILCS 5/13-103(a). If profits become too high, a competitor is expected to enter the market with lower prices, and thereby drive prices down closer to cost. In this way, competition provides price constraints, furthering the goal of affordability. However, if reported profits are unreasonable and unfair and prices increase without any discernible constraint, it is clear that the competition is not working, and that regulatory review is necessary to preserve the goals the General Assembly established in Section 13-103. 220 ILCS 5/13-103. These are particularly relevant concerns in an industry with barriers to entry (such as significant investment and/or infrastructure requirements) and where competitors rely on a single supplier such as the ILEC for essential inputs.

A just and reasonable rate for telecommunications services classified as competitive should result in a fair relationship between costs and profits, and should promote the values recognized by the General Assembly, including affordability, quality, choice and competitive rates that are not subsidized by non-competitive rates. Rates should be non-discriminatory and consistent with the goals of universal service. A rate increase that results in an unreasonable mark-up over cost and bears no relation to other public interest goals such as universal service and affordability should be subject to review under the just and reasonable standard so that the public interest and investors' interests remain fairly balanced.

In response to (c), see responses above on pages 9-11, which address items i. through xii. in this question.

Q. Can the Commission rely on market forces to ensure that rates for competitive telecommunications services (as identified and specified by the PUA) are just and reasonable without abrogating its responsibility to review such rates under Section 13-505?

a) If yes, please identify and explain any circumstances required to make this possible.

b) If no, please explain how any such circumstances can be objectively identified and measured.

No, the Commission cannot rely on market forces alone to ensure that rates are just and reasonable. The General Assembly did not remove telecommunications rates from the just and reasonable standard or from regulatory review upon being declared competitive, as discussed more thoroughly above at pages 6-7. Rather, in response to changes in federal telecommunications policy, the General Assembly declared Illinois telecommunications policy to use competition to promote consumer interests:

> Policy. Consistent with its findings, the General Assembly declares that it is the policy of the State of Illinois that:
>
> (a) telecommunications services should be available to all Illinois citizens at just, reasonable, and affordable rates and that such services should be provided as widely and economically as possible in sufficient variety, quality, quantity and reliability to satisfy the public interest;
>
> (b) consistent with the protection of consumers of telecommunications services and the furtherance of other public interest goals, competition in all telecommunications service markets should be pursued as a substitute for regulation in determining the variety, quality and price of telecommunications services and that the economic burdens of regulation should be reduced to the extent possible consistent with the furtherance of market competition and protection of the public interest;
>
> (c) all necessary and appropriate modifications to State regulation of telecommunications carriers and services should be implemented without unnecessary disruption to the telecommunications infrastructure system or to consumers of telecommunications services and that it is necessary and appropriate to establish rules to encourage and ensure orderly transitions in the development of markets for all telecommunications services;
>
> (d) the consumers of telecommunications services and facilities provided by persons or companies subject to regulation pursuant to this Act and Article should be required to pay only reasonable and non-discriminatory rates or charges and that in no case should rates or charges for non-competitive telecommunications services include any portion of the cost of providing competitive telecommunications services, as defined in Section 13-209, or the cost of any nonregulated activities;

220 ILCS 5/13-103. The General Assembly welcomed competition on the expectation and condition that consumer rates remain just, reasonable, affordable and consistent with the public interest. The law does not dispense with all review upon the declaration of competitive status.

The wisdom of the law is particularly relevant to the case where competitors are dependent to any significant degree upon wholesale services obtained from the ILEC. As noted previously, as of December 31, 2004, 61% of CLEC lines relied on UNEs (i.e., ILEC facilities) in MSA 1, while in other MSAs the percentage was 97-98%. Even facilities-based providers, such as cable television companies, must purchase pole attachments and conduit space from the ILEC, and must pay the ILEC for inspections, make-ready work, and various other installation and maintenance tasks, in addition to recurring pole and conduit rental fees. Where the ILEC controls the wholesale price, it can influence the retail price its competitors charge, rendering the latter ineffective as a constraint on the ILEC's own retail prices.

Further, the concerns addressed in the law (e.g., extra-ordinary profits, discrimination, and violation of public policy) can arise even where there are alternative providers for the service in question. Large companies may be able to set rates without regard to the rates of smaller companies that lack the ability to serve larger numbers of consumers and therefore threaten their hegemony. Further, differences among services may provide perverse incentives for companies to design rates that hide costs (e.g. internet telephone rates that do not include the cost of the internet connection, rates that make unbundled service difficult to identify or purchase).

Rates for services that serve niche markets, or target consumers in special circumstances (e.g. institutionalized persons, poor credit, low-income or Lifeline recipients, areas with minimal choice) may not be constrained by viable alternatives although consumers in other areas do have choice (e.g. uneven availability of high speed internet or facilities based competition). The factors discussed above must be reviewed to assess whether the rates of companies that offer services defined as competitive are just and reasonable even if there are competitive alternatives available.

The People of the State of Illinois, by Attorney General Lisa Madigan, thank the Commission for the opportunity to comment on this important issue.

Very truly yours,

Janice A. Dale
Bureau Chief
Public Utilities Bureau
100 West Randolph
Chicago, Illinois 60601
(312) 814-3736
jdale@atg.state.il.us

Susan L. Satter
Senior Assistant Attorney General
Public Utilities Bureau
100 West Randolph
Chicago, Illinois 60601
(312) 814-1104
ssatter@atg.state.il.us